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IN THE

Supreme Court of the United States

OCTOBER TERM, 1935.

No. 108

JOSEPH E. SWANSON, et al., As Trustees of the LAKE VIEW LAND ASSOCIATION,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF FOR PETITIONERS

ON WRIT OF CERTIORARI
TO THE UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

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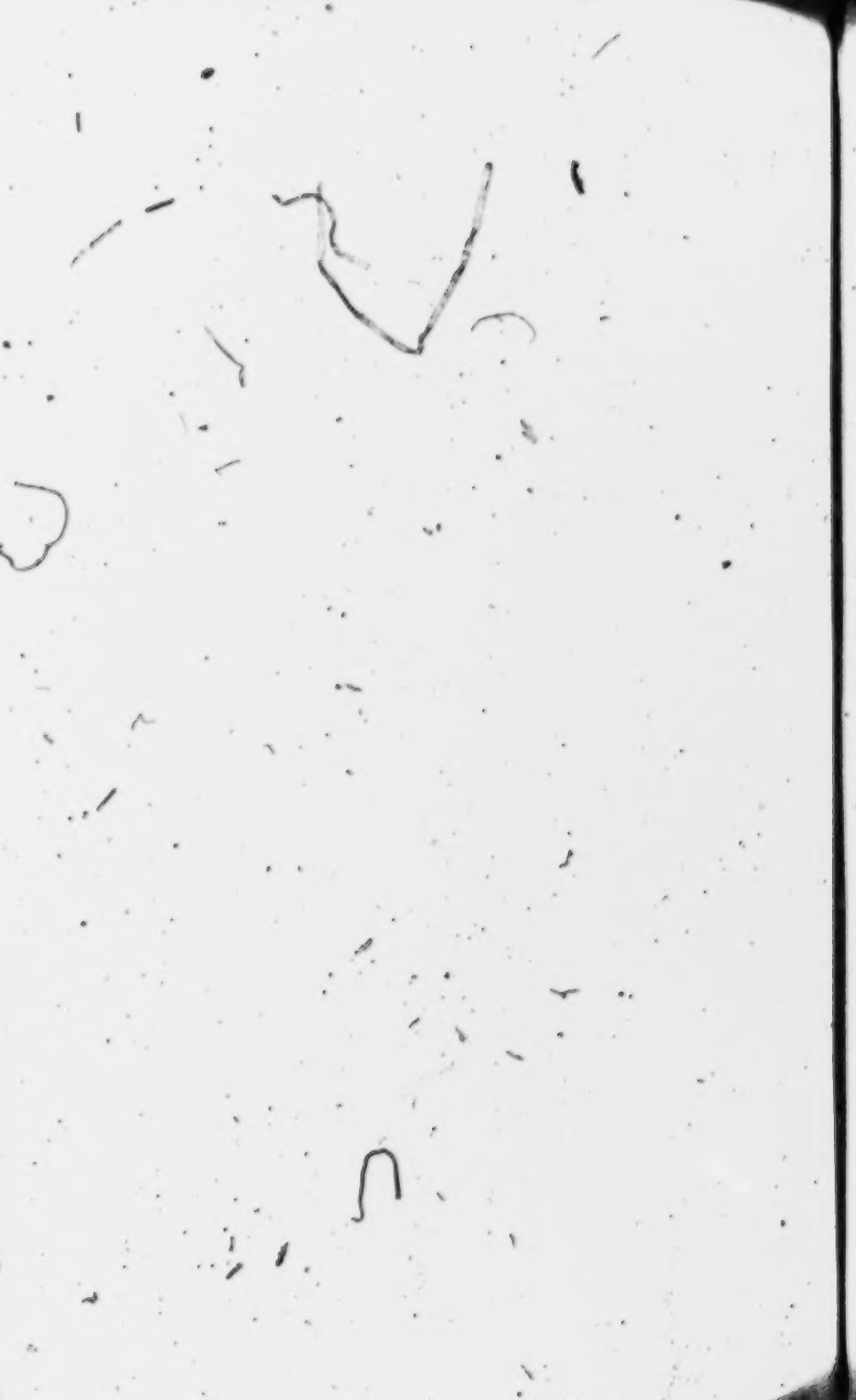

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IN THE

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No. 108

JOSEPH E. SWANSON, ET AL., AS TRUSTEES OF THE LAKE VIEW LAND ASSOCIATION,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF FOR PETITIONERS

STATEMENT OF THE CASE.

Jurisdiction.—This case is before this Court on a writ of certiorari, granted October 14, 1935, to review a decision of the United States Circuit Court of Appeals for the Seventh Circuit, which affirmed decisions of the United States Board of Tax Appeals sustaining the determination of income tax deficiencies for the years 1925 and 1926.

Opinion Below.—The opinion of the Circuit Court of Appeals (R. 40-46) is reported at 76 Fed. (2d) 651-653.

The Board of Tax Appeals rendered a memorandum opinion (R. 19-30), which is not officially reported. After reciting the facts found by the Board, this opinion states that the decision is governed by the case of *Joseph E. Swanson, et al., Trustees of the Fullerton Parkway Land Trust*, 29 B. T. A. 1123.

The Question Presented.—The only issue in this case is whether the income of the Lake View Land Association for the years 1925 and 1926 was subject to tax as the income of a trust, under Section 219 of the Revenue Act of 1926 (c. 27, 44 Stat. 32), or whether the trust was an "association" under Section 2 (a) (2) of that Act (44 Stat. 9), so that its income was taxable under Section 230 (44 Stat. 39) as the income of a corporation.

More specifically, the question is whether an "association" which is taxable as a corporation was created by two owners of a three-story apartment building, in which one of them lived, who transferred title to themselves and another as trustees, where the property was managed by one of the owners, as a partner of the real estate management firm which was employed as the agent for the trustees, in consultation with the other owner. During the taxable years here involved, the beneficial owners were the wives of the original owners.

The petitioners contend that this is a case of simple joint ownership of income producing property, and that the income should be taxed directly to the individual owners, as it is under the trust method. A greater tax is imposed if there was an "association."

Specification of Error.—The only error to be argued is that the Court below erred in failing to reverse the decision of the Board of Tax Appeals, as erroneous in law,

on the ground that the decision of the Board was not sustained by the facts found by the Board but was in conflict with those facts, which required the conclusion in law that this trust was not an "association" under the statutory provisions involved.

The Facts—A condensed statement of the facts was contained in the opinion below (R. 44-45) and is here reprinted in full (interpolations [*in brackets and italic type*] and footnotes having been supplied), as follows:

> "Joseph E. Swanson and Ralph C. Otis were the owners of a three-story apartment building containing nine apartments [*which had been completed more than a year before the trust was created* (R. 26)]. On June 1, 1915, [*at the suggestion of their attorney* (R. 27)] they entered into a trust agreement for the purpose of carrying the title to the real estate. [*At that time, and until 1926, the petitioner Swanson was living in one of the apartments* (R. 28)]. The first trustees were Ralph C. Otis, Joseph E. Swanson, and Allen G. Mills. In 1926, James Otis succeeded his father as trustee.
>
> "Under the trust agreement, the trustees were given the complete management and control of the property, to exchange, reconstruct, remodel, sell or improve at their discretion or to borrow money secured by the property. They were authorized to rent suitable quarters for the transaction of the business of the trust and employ such assistants as they required. The agreement provided for the issuance of 'receipts' to evidence the interests of the beneficiaries, representing 1,000 shares at the par value of $100 each. It was provided that the receipts were evidences of the ownership of personal property and not real estate. They might be transferred by assignment. Originally, one-half of the shares were issued to Otis and one-half to Swanson, who later transferred their interests to

their wives, who owned the shares during 1925 and 1926. The agreement provided that the trust could sue and be sued;[1] that neither the trustees nor the beneficiaries should be personally liable[2] and that all persons dealing with the trustees must look only to the property of the trust; that it should be terminated at the expiration of twenty years after the death of the last survivor of certain named persons or by the trustees in their discretion at any time before the expiration of the twenty years by selling all the property held by them as such and distributing the net proceeds of such sale. The trust had succession and was not terminated by the death of a trustee or beneficiary. * * *

"The trustees of the Lake View Land Association never assembled in formal meetings, never adopted resolutions or took formal action with reference to the affairs of the property, kept no minute book, had no by-laws. They elected no officers and no so-called board of directors."

In addition, the following noteworthy facts were included in the findings of the Board of Tax Appeals.

The property to be acquired was specifically described in the trust agreement (R. 19). This property has not been sold, although there have been many opportunities to sell at a large profit; nor have the trustees ever ac-

---

[1] This must imply that the trustees could sue and be sued *as individuals*, and not the trust as an entity, as that would not be sanctioned by the law of Illinois. *Wahl* v. *Schmidt*, 307 Ill. 331, 138 N. E. 604.

[2] This provision would be without legal effect in Illinois, in that the trustees would nevertheless remain personally liable, with a claim for reimbursement from the trust estate. *Austin* v. *Parker*, 317 Ill. 348, 148 N. E. 19. And see discussion herein, at page 35.

quired or negotiated for the purchase of any other real estate (R. 28, 29).

The renting of the apartments in the building and all other necessary management of the property, and also the distribution of the net income, was done by a partnership known as Willoughby & Co., of which Joseph E. Swanson was a partner. This firm was engaged in the business of buying and selling real estate as a broker and in the business of managing properties (R. 27). The management of the property by Willoughby & Co. was directed by Ralph C. Otis and Swanson, and the entire affairs of the trust were at all times in their hands (R. 27-28).

SUMMARY OF ARGUMENT.

The Lake View Land Association, it is submitted, should not be taxable as a corporation under almost any definition of the statutory term "association." It was not engaged in carrying on a business and it employed none of the characteristic corporate forms of organization or methods of procedure. It was merely an arrangement for the convenient holding of the title to a single parcel of real estate owned by two individuals as an investment. Essentially it was a simple joint venture.

Its counsel do not agree, however, with the position taken by counsel for the Government (in the brief heretofore filed upon the same question in the pending case of *Morrissey, et al.* v. *Commissioner*, Docket No. 17) as to the general rule of distinction between an "association" and an enterprise which is otherwise taxable.

It has already been established by the decisions of this Court that an "association" exists for this purpose only where there is substantial resemblance to a corporation.

The present issue concerns entirely the identification of those characteristics in which resemblance is significant and the determination of the relative importance of various features of similarity and difference.

The principal conflict in the decisions of the Circuit Court of Appeals, and between the parties here, relates to the contention of the Government either that the conduct of business is alone conclusive, or at least that it is of primary significance. Counsel for the Government argues that it need be accompanied only by the additional corporate attributes of centralized control, continuity of existence, and limited liability. We contend that the particular corporate attributes mentioned are entirely without significance, since they are traditionally characteristic of a true trust, as well as of a corporation. We further contend that the doing of business is not a conclusive test (except perhaps in the negative sense, in that there is no association unless a business is carried on), and that this is merely one element among many to be considered.

Classification as an association, we submit, should depend upon a weighing and balancing of resemblance to a corporation with respect to a number of characteristic and distinctive features of form and mode of organization and procedure, which have varying degrees of relative significance. As has been held in many decisions, even when a trust is engaged in business, it is properly subject to tax as an "association" only if there is a preponderance of resemblance to a corporation with reference to all relevant features of similarity or difference. The obvious purpose and intention of Congress, that the tax burdens imposed upon business corporations should likewise be shared by those unincorporated enterprises which are essentially similar to corporations, can not be effectuated by any simple and categorical test.

Of the many corporate characteristics which have been regarded as significant in this connection, only three seem to be essential, and then only in a negative sense. We submit that there can be no "association" except (1) by the voluntary act of the interested parties, who have adopted at least (2) some minimum of structure of organization and formality of procedure, through which they are engaged in (3) carrying on a business.

The familiar case of the creation of a business trust, even under a formal organization, by a testator or settlor for the benefit of other persons should not be included. Further, where there is no formality of organization or procedure except the holding of title to property in trust, voluntary association for a business purpose is not to be distinguished as a basis of classification for income tax liability from the typical partnerships, syndicates, pools, and many other forms of joint adventure which have never been regarded as taxable as corporations.

Even the three corporate characteristics above mentioned, however, should be considered in connection with others which are important even though they have perhaps less weight, including the following:

(4) Control of the enterprise by the beneficiaries, particularly if exercised through the characteristic corporate method of election.

(5) Majority rule, that is the power of a majority to bind all the interested parties, as contrasted with the requirement for unanimous consent.

(6) The aggregation of large capital contributed by a large number of investors.

(7) Preferences and priorities among owners.

(8) Legal entity or personality, or some of its attributes, such as the power to sue and be sued or other recognition or control by state statute.

Many details of form or procedure, such as a managing board, officers, meetings, records, reports, name, and seal, are frequently mentioned as independent grounds of resemblance to a corporation. It seems, however, that while they indicate some formality of organization or other essential element of resemblance to a corporation, and may become important in connection with other features, no one of them should have much weight standing alone.

The term "limited liability," loosely used to designate an alleged corporate characteristic, in fact offers no basis for distinction. Although the limited liability of shareholders is a most important corporate attribute, it is equally characteristic of a true trust that the beneficiaries incur no personal liability. On the other hand a "trust association" normally involves the personal liability of the beneficiaries. Under any trust, whether or not an "association," the trustees incur unlimited personal liability notwithstanding provisions to the contrary in the trust instrument, except as otherwise provided by statutes or specific contracts.

A continuity of succession, regardless of changes of trustees or transfers of beneficial interests, is characteristic of all trusts, as well as of corporations.

Under any general rule or test, the Lake View Land Association should not be taxed as an "association" because it had no essential resemblance to a corporation. It employed none of the forms of organization or methods of procedure which are characteristic of corporations. Its income-producing activities (which must obviously be of primary significance in the determination of classification for income tax liability) were no different in any essential feature of method or form from those of a typical joint venture. The trustees (later their wives) were themselves the beneficial owners of the property, and all their func-

tions as trustees were performed exactly as if the title had been held merely in a simple tenancy in common.

The trust was not engaged in carrying on a business. For this purpose, it has been generally recognized that the holding of investment property, requiring no extensive activities, is to be distinguished from the active conduct of a commercial business, including the buying and selling of real estate. As to the character and extent of its business operations, the Lake View Land Association was obviously much less engaged in the conduct of a business than were the enterprises which have been held taxable as trusts in many other cases, including several decisions of the Circuit Court of Appeals for the Seventh Circuit, and including the case of the Coleman-Gilbert Associates which is now before this Court.

Since the Lake View Land Association had no substantial resemblance to a corporation in form of organization or method of operation, it should not be taxed as an association.

ARGUMENT.

(1) The Term "Association" Includes Only Those Organizations Which Have the Essential Characteristics of Business Corporations.

Under almost any definition of the term "association" the Lake View Land Association, as is later argued herein, should not be taxable as a corporation. Consequently it may be questioned whether this brief would be justified in discussing at great length the fundamental questions involved in the many decisions which have dealt with the definition of that term. This is particularly true since these questions have already been and will be presented to this court in the pending case of *Morrissey*, et al. v. *Commissioner*, Docket No. 17, previously argued and submitted, and in the following cases which are to be argued at the same time as the present case, namely: *Helvering* v. *Coleman-Gilbert Associates*, Docket Nos. 78, 79; *Helvering* v. *Combs*, Docket No. 238.

The consideration of the particular facts of the present case, however, requires a foundation of general discussion of the principles to which these facts are to be related. Moreover, although it is argued that this case should be decided in favor of the taxpayer even under the general rules which Government counsel has advocated in other cases and presumably will here urge, the counsel for the Lake View Land Association do not acquiesce in the position taken for the Government. It is therefore necessary at least to review the major aspects of the

general grounds of distinction between an enterprise which is taxable as an "association" and one which is taxable as a trust.

We are here concerned merely with the particularization of a general rule which is already clearly established. The general definitions of the term "association" were set forth by this court in its much-quoted opinion in *Hecht* v. *Malley*, 265 U. S. 144, 157, decided May 12, 1924. Ten years ago, in the case of *Burk-Waggoner Oil Association* v. *Hopkins*, 269 U. S. 110, decided November 16, 1925, this Court said (at pages 113, 114), referring to joint stock associations:

> "They have usually a fixed capital stock divided into shares represented by certificates transferable only upon the books of the company, manage their affairs by a board of directors and executive officers and conduct their business in the general form and mode of procedure of a corporation. **Because of this resemblance in form and effectiveness,** these business organizations are subject by the Act to these taxes as corporations."

In view of these prior decisions of this Court and the arguments presented by all the parties in the [illegible]ed cases now under consideration by this Court, it is submitted that all may agree upon the following statement of the general rule:

> **Any association of individuals, for any purpose, is taxable as a corporation if it sufficiently resembles a corporation in those characteristics which are essential or substantially important with relation to the subject matter of the statute in question, namely the receipt of income. Without such essential resemblance to a corporation, there is no "association" taxable as a corporation.**

The difference of opinion relates entirely to the identification of those characteristics which are substantial, as distinguished from those which are merely incidental. The conflict in the decisions of the Circuit Courts of Appeals, and the issue between the parties here, are concerned wholly with such distinctions, including the questions:

(1) Whether the conduct of business is alone determinative, is merely one of the factors to be weighed, or is entirely irrelevant?

(2) Whether form of organization and method of procedure are controlling, merely indicative, or entirely irrelevant?

(3) What characteristics of form of organization and method of procedure are significant at all, and what weight is to be given to those which are significant?

It is here contended, first, that the doing of business is an element to be considered but is not a conclusive test (except perhaps in a negative sense), and, second, that classification as an association should depend upon a weighing and balancing of resemblance to a corporation in a number of characteristic and distinctive features. The points of resemblance which are frequently referred to (including some which, it is submitted, should in fact have no significance) and others which seem to us to be significant, will be separately considered.

(a) The "business test" is not determinative (except that there is probably no "association" if no business is carried on).

Counsel for the Government argues (page 13 of brief in the *Morrissey* case, Dkt. No. 17) "that a trust under

which a combination of persons were doing business would be an association irrespective of beneficiary control and, in the alternative, that if that decision [*Hecht* v. *Malley*] made the further requirement that the trust must resemble a corporation, this requirement was simply that the trust should have the attributes of a corporation such as centralized control, continuity of existence and limited liability, regardless of forms used in effecting them."

Again (*Morrissey* brief, page 21), it is urged that "either the business test must be considered conclusive in itself or conclusive where there are some or all of the elements of centralized control, limited liability and continuity of the business regardless of death or transfers of interest and that it is not important whether the trust has certificates of stock or other external features of a corporation."

Although it is later contended herein (page 39) that even if "the business test must be considered conclusive in itself," the Lake View Land Association would not be an association for the reason that it was not engaged in the conduct of a business, within the scope of that term as here employed, it may first be briefly argued that the position of Government counsel, as above stated, is unsound in this respect. The alternative contention of Government counsel as to the other significant features is later considered.

The conduct of a business, or the business character of the trust activities, is not even mentioned in the definitions quoted by this Court in *Hecht* v. *Malley*, 265 U. S. 144, 157, which refer only to "the prosecution of some common enterprise" and "the prosecution of some purpose." As compared with the overemphasis upon this feature of distinction in the language of some of the decisions upon which the Government counsel relies, the rule here advocated has been stated by the Circuit Court of Appeals for

the Tenth Circuit in *Commissioner* v. *Brouillard*, 70 Fed. (2d) 154, certiorari denied under title of *Helvering* v. *Pryor & Lockhart Development Co.*, 293 U. S. 574, as follows:

> "The fact that a group associate themselves together for the purpose of engaging in business for profit does not necessarily mean that they must be taxed as an association. That is not the decisive consideration."

The Circuit Court of Appeals for the First Circuit has expressed the same view, in the case now under review, *Coleman-Gilbert Associates* v. *Commissioner*, 76 Fed. (2d) 191, as follows:

> "We think, however, it is generally agreed that, in order for a trust to be taxed as a corporation, the trustees must not only be carrying on a business enterprise for profit, but must be doing it in much the same manner and form as directors of a corporation."

A similar attitude was expressed by the Circuit Court of Appeals for the Seventh Circuit in *Commissioner* v. *Morriss Realty Co. Trust*, 68 Fed. (2d) 648, affirming the Board of Tax Appeals. There the Court held that there was no association in the case of a family real estate trust, which subdivided tracts conveyed by the original grant and several other tracts subsequently purchased by the trustees, sold lots on installments, erected houses, the cost of which was in part obtained from mortgages, and sold such houses on time contracts. The Court said:

> "When these Regulations upon which the Commissioner relies are examined, it must be observed that to be taxed as a corporation the trust must be one which 'acts or does business in an organized capacity' (1502), and where the trustees 'are associated together in much the same manner as directors in a corporation for the purpose of carrying on some business enterprise' (1504). * * *

"There is scarcely any trust which, in its administration, does not necessarily involve the doing of some kind of business.

"To give the Regulations and the Treasury Decision the construction contended for by the Commissioner in this case would have the force and effect of nullifying the express provisions of the statute providing that trusts shall be taxed as individuals. The expression 'for the purpose of carrying on some business enterprise' as used in the Regulations and Treasury Decision referred to, and which was undoubtedly designed to comply with what the Supreme Court said in *Hecht* v. *Malley, supra,* must be limited to trusts which carry 'on some business enterprise' for the purpose of gain or profit and under some type of corporation organization."

The fact that an enterprise is engaged in active business is at least an element of resemblance to the typical corporation, as opposed to the typical holding trust. Very many corporations, however, are engaged in the mere holding of property, in operations not for profit, or in other non-business activities, and very many typical true trusts are engaged in the active conduct of businesses of all kinds. In addition, much business is carried on by ordinary partnerships, syndicates, pools, and other groups which clearly are not "associations." Although it may be true that *most corporations* which are subject to corporate income tax are engaged in carrying on business, it certainly is not true that *most business* is carried on by such corporations. Therefore, this ground of classification as an "association" must be given merely a contributory significance in a case otherwise very close.

It is significant that business activities of great variety, volume, and continuity have been carried on by trusts which have nevertheless been held not to be associations.

The essential features of such decisions may be briefly indicated as follows:

Commissioner v. *Brouillard*, C. C. A. 10, 70 Fed. (2d) 154, certiorari denied under title of *Helvering* v. *Pryor & Lockhart Development Co.*, 293 U. S. 574, affirming the decisions of the Board of Tax Appeals. Three oil development syndicate trusts (one of which was also held not an association in *Commissioner* v. *Duckwitz*, C. C. A. 7, 68 Fed. (2d) 629). The trustee of the so-called Pryor & Lockhart Development Co. procured the drilling of six oil wells on the trust property by an agreement with drilling contractors, and also arranged for the drilling of two wells by the same contractors upon the property of two other owners. The oil produced from the trust property was sold. After paying current expenses, the trustee distributed the net income among the beneficiaries, using the employees of a partnership of which he was a member. The trustee also employed a superintendent and pumper.

Commissioner v. *Kelley*, C. C. A. 1, 74 Fed. (2d) 71, affirming Board of Tax Appeals. Trustees conducted an active manufacturing business under the name of Union Paste Co.

Commissioner v. *Guitar Trust Estate*, C. C. A. 5, 72 Fed. (2d) 544, reversing Board of Tax Appeals on other grounds but sustaining its holding that a trust managing large tracts of real estate and much personal property and carrying on a ranching business, a cotton business, and a cotton seed business, was not taxable as an association.

Lucas v. *Extension Oil Company*, C. C. A. 5, 47 Fed. (2d) 65, affirming the Board of Tax Appeals. Drilling an oil well, including employment of labor, furnishing of material, etc.; production and sale of oil, and collection of oil royalties; sale of lease.

Blair v. *Wilson Syndicate Trust,* C. C. A. 5, 39 Fed. (2d) 43, affirming the Board of Tax Appeals. Operation of a twelve story office building and an eight story office building; joint ownership of a theater property, another rented building and two cattle ranches, each of which was operated by another of the joint owners; the exchange of an office building for cattle ranches, which were thereafter operated under contract on behalf of the trustees.

Fisk, et al. v. *United States,* District Court, Mass., 60 Fed. (2d) 665. Eleven parcels of land were sold and a building was remodelled into four separate buildings, of which two were sold.

The Board of Tax Appeals, which began by giving unduly great weight to the "business test," misconstruing the decision of the Supreme Court in *Hecht* v. *Malley,* has in its later decisions consistently recognized the rule that there is an "association" only when the conduct of a business is accompanied by some measure of employment of essential corporate forms and procedure.

See:

Dolese & Shepherd Co., 30 B. T. A. 1171.

E. A. Holmes, 27 B. T. A. 1229.

Pryor & Lockhart Development Co., 26 B. T. A. 1054, affirmed by *Commissioner* v. *Brouillard,* C. C. A. 10, 70 Fed. (2d) 154.

Rollin S. Sturgeon, 25 B. T. A. 368.

Jackson-Wermich Trust, 24 B. T. A. 150.

It is submitted that what should be merely a negative rule has been improperly extended into a positive one. We agree that if a trust is not engaged in the conduct of a business it should not be classified as an association, except perhaps that a number of other considerations might some-

times clearly require the contrary result. In other words, it should normally be true that to be an association a trust must be engaged in the conduct of a business. On the other hand, we agree that to carry on business, while not alone a sufficient reason for subjecting a trust to income tax liability as a corporation, is one of those characteristics of a business corporation which should be taken into consideration in resolving this issue. But to say that every trust which is engaged in active business is for that reason taxable as an association ignores entirely the fundamental basis of the statutory classification, which this Court has said rests upon a "resemblance in form and effectiveness."

The Board of Tax Appeals has made what appears to be a correct application of the rule. In the case of *Terminal Properties Co.*, 19 B. T. A. 584, the Board said:

> "An association is an unchartered organization employing the characteristic form and procedure of a corporation in the prosecution of a business enterprise. The test to be applied is pragmatic. Did the syndicate in its purpose, form and operations so resemble a corporation that it should be taxed as such? * * * Concluding as we do that the syndicate was not engaged in any business enterprise it follows *per necessitate* that it did not employ the forms and procedure usually followed by incorporated bodies in carrying on a business."

It is therefore submitted that even when a trust is engaged in business, it is properly subject to tax as a corporation only if it is substantially similar to a corporation in the essential characteristics of form and procedure. If the trust is not engaged in business, it is not to be taxed as a corporation unless other considerations clearly require that result.

(b) In many features of organization and procedure, of varying significance, there must be a preponderance of resemblance to a corporation.

The problem of disposing of thousands of cases involving infinite variations of fact has naturally created a strong desire for a simple test which would mechanically distinguish an "association" from an enterprise otherwise taxable. Any such result, however, would be directly in conflict with the broad and elastic rule of the statute and the prior decisions of this Court. It was obviously the purpose and intention of Congress that the tax burdens imposed upon business corporations should likewise be shared by those unincorporated enterprises which are essentially similar to a corporation in form of organization and mode of operation. This essential similarity can not be determined with reference to any one feature or aspect, since this may be inconsistent with some other comparison of equal significance. Necessarily, therefore the resemblance must be appraised with reference to all relevant features of similarity or difference.

We can agree completely with the position of the Government (*Morrissey* brief, p. 24) that "the attributes which are important are those of substance and not of form." This, however, answers nothing but merely presents the essential question, which is to distinguish between the substantial and the merely formal differences between the corporate or association type and the trust type of relationship.

The voluminous litigation and literature relating to the so-called Massachusetts trusts and similar trusts, as well as the income tax cases involving such trusts, indicate that a typical trust of that character frequently, if not ordi-

narily, employs many forms and methods of procedure which are characteristic of corporations, including most frequently:

(a) Periodical meetings of beneficiaries.

(b) Election of managing trustees, serving for short terms, by beneficiaries, by majority vote in formal meeting.

(c) Control of the trustees and their activities by the action of a majority of those beneficially interested, voting in formal meetings.

(d) Action of the managing trustees only as a body, meeting as such, rather than as individuals.

(e) Selection by the trustees of managing officers, having titles and duties similar to those of corporations.

(f) The issuance of shares of different classes, including some with preferences as to dividends or in liquidation.

(g) The conduct of a commercial business, under a trade name.

(h) Capacity to sue and be sued as an entity, under state statutes.

For illustration, see:

Little Four Oil & Gas Company v. *Lewellyn*, C. C. A. 3, 35 Fed. (2d) 149, certiorari denied, 280 U. S. 613. Common and preferred stock; annual meetings of shareholders.

Trust No. 5833, Security-First National Bank, etc. v. *Welch*, 50 Fed. (2d) 613, affirmed, C. C. A. 9, 54 Fed. (2d) 323, certiorari denied, 286 U. S. 544. A "board of syndicate managers," chosen by and removable by beneficiaries.

Pritchett, et al. (3 cases), 17 B. T. A. 1056, 1064, 1071. Preferred and common shares; name; meetings of beneficiaries; successor trustees elected by beneficiaries.

E. A. Landreth Co., 11 B. T. A. 1. Capacity to sue and be sued as an entity; seal and name; shareholders, by majority vote, could remove trustees and fill vacancies.

Durfee Mineral Co., 7 B. T. A. 231. Joint stock association; capacity to sue and be sued as an entity; officers, by-laws, minutes, seal, name; meetings of beneficiaries.

It may be questioned whether any test is conclusive, except in the negative sense. That is, there seems to be no corporate characteristic which is of itself so significant that it alone would always indicate an association. Several, however, may be so important that the absence of any one of them would be inconsistent with association status. For example, an enterprise which much resembled a corporation in formal organization might not be properly taxable as such because it was not engaged in any business, or because it was organized under a will rather than by the voluntary action of the beneficiaries. On the other hand, it seems clear that a voluntary enterprise for the conduct of an active business under the control of the owners is not to be distinguished from an ordinary partnership if it is entirely lacking in the organization and procedure of a corporation.

It is therefore submitted that any attempt to formulate a simple and categorical rule for distinguishing an "association" from enterprises otherwise taxable is misdirected and misleading. Apparently this is simply one more of the

numerous legal distinctions which must rest upon the weighing and balancing of a number of factors, all of which are relevant but none of which are conclusive. The present problem is to isolate and identify such factors, and to determine their relative weight.

Only by analysis of the characteristic corporate form and procedure into its separate elements can this problem be intelligently discussed. We therefore submit the following enumeration of corporate characteristics, each of which is separately discussed below, which we believe fall into the four classes described.

Corporate Characteristics

In Order Of Importance

I. *Negatively essential—that is, the lack of any one of these characteristics would tend strongly to indicate that there is no "association":*

1. Voluntary association.
2. A minimum of formal organization.
3. Business activity.

II. *Very significant if present, but not essential:*

4. Control of enterprise by beneficiaries.
5. Majority rule.
6. Aggregation of large capital contributed by a large number of investors.
7. Preferences and priorities among owners.
8. Attributes of legal entity.

III. Having some little significance if present, but absence not significant:

9. Details of form or procedure—managing board and officers; meetings, records, and reports; name and seal.

IV. Having no significance, because, although ostensibly characteristic of corporations, in fact equally characteristic of trusts:

10. Limited liability.

11. Continuity.

12. Transferability of interest; issue of certificates.

The brief of the Government in the *Morrissey* case (pp. 7, 13, 21) assumes without discussion that the essential attributes of the corporate form are:

> Centralized control (referring not to control by the beneficial owners but to the control of the enterprise by the managing agency);
>
> Continuity of existence (regardless of death or transfer of beneficial interest);
>
> Limited liability.

The difficulty about this suggestion is that each of these attributes is essentially characteristic of the typical true trust, as well as of the corporation.

In the same brief it is pointed out (pp. 21-22) "that the ordinary trust *per se* has certain corporate attributes in that ordinarily there is no personal liability of trustees or beneficiaries and the beneficiaries are free to dispose of their beneficial interests." While this statement is apparently incorrect with reference to the personal liability of

the trustees hereinafter licensed), indicates that two of the features named as counsel and commonly regarded as significant, namely, the absence of personal liability of beneficiaries and the transferability of beneficial interests without interrupting the continuity of the enterprise, are equally characteristic of the one trust and the corporation. On the contrary, unlimited liability of the beneficiaries is quite characteristic of an association as shown below. Consequently these features have no value for distinguishing an association from a one trust.

Voluntary Association

We would put at first place as a negative requirement that the association must be the voluntary act of those beneficially interested. The familiar case of a testator or settlor who establishes a business trust for the benefit of donees has obviously no resemblance to the typical situation of the unincorporate form by persons who seek a common objective. While not every voluntary group is an "association," certainly there is no such taxable entity where the members of the group have not joined it by their own will.

One of the first and most striking instances of difficulty and resistance encountered in the attempt to apply the "business" test was the case of *Blair v. Wilson Syndicate Trust*, [ ] U. S. [ ], 9 Fed. (2d) 43, where the Court said (pp. 43, 46):

> "It is contended that the test is whether the respondent was conducting a business and the beneficiaries had control of the trustees. . . . The test urged by the petitioner has no application to the facts in this case. A distinction is to be made between an agreement between individuals in the form of a trust and an express trust created by an ancestor, although

> they may have some features in common. The controlling distinction is that one is a voluntary association of individuals for convenience and profit, the other a method of equitably distributing a legacy or donation."

Although this case actually demonstrates that all elements of resemblance to corporate forms and procedure are important, it has been interpreted as the authority for a limitation upon or exception to the rule of the "business test." Thus, the Board of Tax Appeals has said, in *Morriss Realty Company Trust*, 23 B. T. A. 1076, affirmed 68 Fed. (2d) 648:

> "Where the ancestral element has been present and the evident object of a trust has been liquidation of property, the Board has followed the principle of *Blair* v. *Wilson Syndicate Trust*, *supra*, and held such bodies trusts and not associations."

For a later qualification of this rule, see *Dauphin Deposit Company*, 21 B. T. A. 1214.

2. *A Minimum of Formal Organization*

Clearly there can be no "association" without some structure of organization and some formality of procedure. Informal association for business purposes is characteristic of partnerships, syndicates, pools, and many forms of joint adventure, which have never been regarded as taxable as corporations under the Federal income tax laws.

As the court said in *Bouchard* v. *First Peoples Trust*, 253 Mass. 351, 361 (involving a question of state legislation):

> "The various definitions of the word 'association', all imply, if they do not require, as an essential element, that there be some form of organization re-

sembling modes of procedure inherent in incorporated bodies. A business corporation is unthinkable where the shareholders are devoid of legal rights, have no officers and are and must remain forever dumb as to the selection, approval or disapproval of managers and methods of conduct of corporate affairs."

Certain elements of formality of organization are often referred to as independent corporate characteristics, including a managing board, officers, meetings, records, reports, a name and a seal. It is submitted that these features have merely incidental significance with reference to this and other more essential aspects of resemblance to a corporation.

The "centralized control" to which Government counsel refers (*Morrissey* brief, pp. 13, 21) can not serve as the required minimum of formal organization, since any trust necessarily provides a centralized control and management of the trust property.

The entire absence of employment of a corporate form or organization or a corporate mode of procedure has apparently been the ground of the decision that no association existed, without regard to the character or extent of business activities, in a number of cases of the Board of Tax Appeals, involving simple syndicates, as follows:

Myers, Long and Company, 14 B. T. A. 460.
Realty Associates, 17 B. T. A. 1173.
McGlone, 22 B. T. A. 358.
The Royal Syndicate, 20 B. T. A. 358.
Winston, 22 B. T. A. 1194.

Whether an elaborate organization following corporate forms should alone be enough to constitute an "association" is a different and difficult question. At least it would be a significant element to be considered in relation to other resemblances and differences.

3. Business Activity

The fact that an active business is carried on is at least an element of resemblance to the typical corporation, as opposed to the typical holding trust. As above argued (page 12), however, this is not a decisive or controlling test, but has merely a contributory significance or is at most a negative requirement, in that there is no "association" if no business is carried on.

4. Control of Enterprise by Beneficiaries

Control of the management of the enterprise by those beneficially interested, while certainly not to be regarded as a conclusive test, is just as certainly a characteristic feature of the corporate form of organization and must be given some weight. As the Board of Tax Appeals has said, in *Extension Oil Co.*, 16 B. T. A. 1028, 1034, affirmed C. C. A. 5, 47 Fed. (2d) 65:

> "* * * we should not forget that it is the usual custom for stockholders of a corporation to meet at stated intervals and elect directors for stated terms and thus to a certain extent exert control over corporate affairs. The absence of such control is assuredly an element which should be taken into consideration. Here the shareholders could exert no control whatever over the trustees, who were self-perpetuating. In this respect petitioner more closely resembled a trust than an association."

Where an effective control is informally exercised, as where the beneficiaries are themselves the trustees or are in frequent and close contact with the trustees, there is suggested not so much the characteristic corporate procedure but rather the common participation of the mem-

bers of a partnership in the firm business or the control by the parties to a typical joint venture over their common managing agent.

5. Majority Rule

The power and right of a majority to bind the whole group is characteristic of the corporate form of organization, as contrasted with the typical requirement for unanimous consent, except within the rather narrow limits of an original grant of authority, which is traditionally characteristic of partnerships, joint ventures, and trusts. This refers not to the control by the beneficiaries over the managing agency, but to the power of a majority of the beneficiaries to express a decision which is binding upon all.

A somewhat similar but essentially unrelated difference is that a group of trustees is traditionally required to act only by the combined and unanimous action of all of them, while a corporate Board of Directors traditionally acts by the act of a majority of its members. The delegation of authority by a Board of Directors to corporate officers is a characteristic procedure of similar nature.

It has been pointed out in General Counsel's Memorandum, 7475, IX-1 C. B. 177, published as a Ruling of the Bureau of Internal Revenue, that when the co-owners of property "have agreed to be bound by the decision of a majority in interest * * * they have adopted the characteristic mode of action of all associations, and have abandoned the characteristic mode of action of mere co-owners, who, when acting at all, act unitedly."

6. Aggregation of Large Capital Contributed By a Large Number of Investors

An outstanding feature of the economic significance of incorporated business is that the corporation is characteristically an instrument for assembling a large aggregate of capital from a large number of persons for investment in a business. Where the amount of such capital is so large and the number of such persons is so great that the more simple type of partnership, syndicate or joint venture form of organization would not ordinarily be satisfactory, probably an association adapted to those conditions would in that regard bear a material resemblance to a corporation.

On the other hand, corporations have been so extensively used for business ventures involving only a small capital, and only a few stockholders or even a single stockholder, that this point of comparison probably cannot be given more than contributory weight. At least, however, it may be said that, where only a few persons and only a small capital are involved, in these respects the enterprise resembles the typical partnership or joint venture as much as it does a corporation, and therefore that it should not be held an association unless other features require that conclusion.

A somewhat related economic feature which is significantly characteristic of a corporation is the authority of the Board of Directors to distribute income in their discretion and to accumulate a surplus for employment in the business. Frequently trustees of a pure trust are also given the authority to make similar accumulations in their discretion. More commonly, however, trustees are either required to distribute currently all the net income, or ac-

cumulation is restricted as to purpose or amount. This is, then, a feature to be considered but it probably has merely contributory weight.

7. Preferences and Priorities Among Owners

Distinction between classes of shares, such as preferred and common, is decidedly characteristic of the corporate form of organization, and has frequently been employed by business trusts, such as those involved in *United States v. Veal*, 28 Fed. (2d) 1022, and *Little Four Oil & Gas Co. v. Lewellyn*, 35 Fed. (2d) 149. Any trust which utilizes this feature is therein substantially like a corporation and substantially unlike the traditional type of trust in which the postponement of the interest of some of the beneficiaries is not common. If found at all, it is likely to represent a remainder after a life or term interest, or, more rarely, an unsecured or residual interest after a secured or prior interest such as a seller's lien or an annuity.

8. Attributes of Legal Entity

An artificial personality, with the rights and liabilities of a separate legal entity, and a franchise or charter under general or special statute, are, of course, fundamentally and exclusively characteristic of corporations as known to the law of this country, since they could hardly exist in the case of any unincorporated association. The absence of these features may be dismissed as entirely without significance.

Some of the attributes of legal entity, however, such as the power to sue and be sued, are frequently conferred upon trusts of certain kinds by state statutes. This was true of the trusts which were before this Court in the case

of *Hecht* v. *Malley*, 265 U. S. 144. It was there pointed out not only that the Massachusetts trusts there involved employed many corporate forms and methods of procedure, but in addition that under the Massachusetts statutes, they were classified as "associations" and were subject to suit, attachment and execution as if they were corporations.

The opinion states (at page 147):

> "The Massachusetts statutes, however, recognize their existence, and impose upon them, as 'associations,' certain obligations and liabilities."
>
> "[Footnote:] 'By Chapter 441 of the Acts of 1909, the trustees of 'a voluntary association under a written instrument or declaration of trust the beneficial interest of which is divided into transferable certificates of participation or shares' are required to file copies of the instrument of trust with designated public officers and by chapter 18 of the Acts of 1916, such associations may be sued for debts, obligations, or liabilities and their property may be subjected to attachment and execution as if they were corporations. See 2 General Laws 1921, chap. 182."

Again (at page 161), the Court said:

> "We do not believe that it was intended that organizations of this character—described as 'associations' by the Massachusetts statutes and subject to duties and liabilities as such—should be exempt from the excise tax on the privilege of carrying on their business * * *."

Where an unincorporated group is recognized and controlled by statute, a most significant or even controlling resemblance exists which probably should require classification as an association.

9. *Details of Form or Procedure.*

It seems clear that many features which are frequently referred to as significant mean at most that when they are employed there is added ground for finding an "association," but when they are lacking the conclusion is to be affected very little if at all. Standing alone, no one of these features should have much weight; in connection with other elements they may become quite important.

Provision for a managing board is merely one method of accomplishing the formal organization which we consider essential but which may be otherwise provided. It will often involve the element of majority action which has a significance all its own, as above discussed.

Officers similar to those of corporations also evidence the employment of that much of the characteristic corporate form of organization and delegation of authority, but a true "association" could so readily employ other means for the same ends that the absence of such officers can not have much weight.

Meetings of trustees and of beneficiaries indicate a formality of organization which is important, but which probably may exist to the necessary extent without such meetings. Meetings of beneficiaries are chiefly significant in that they imply some control of the enterprise, as by the election of officers, or some element of majority rule. Informal contacts of beneficiaries suggest the participation which is characteristic of ordinary partnerships or joint ventures.

Records of group action are the corrollary of formal meetings. They add evidence of formal organization and operation, as does the practice of issuing reports to beneficiaries. Reports also suggest that the number of per-

sons interested is sufficiently large to produce a resemblance to a corporation.

A name and a seal are details of resemblance to a legal entity or personality, but a true trust commonly adopts a name for convenience, particularly if many business transactions are engaged in.

10. Limited Liability.

The aspect of limited liability has been much discussed upon a foundation of unwarranted assumptions and without recognition of the actual legal situation. Thus, the limited liability of shareholders, which is a most important corporate attribute, is often mentioned while it is ignored that one of the most important attributes of a true trust is that the beneficiaries incur no liability for the acts of the trustees. It is likewise ignored that one of the principal characteristics of a trust association, as distinguished from a true trust, is that the beneficiaries ordinarily incur an unlimited personal liability where an association exists. It is also assumed that a trust instrument can effectively relieve the trustees of an unlimited personal liability, although the law is clearly to the contrary.

(a) *Limited liability of the beneficial owners, although characteristic of corporations, is equally characteristic of trusts.*

Perhaps the limitation of liability of shareholders is the corporate characteristic which would, of all others, first suggest itself as peculiar to corporations. Traditionally, however, this has also been a fundamental characteristic of a trust.

That the beneficiaries of a trust are not personally liable for the acts of the trustees, in the absence of circumstances

which constitute an agency, a partnership, or some relationship other than a true trust, has been so thoroughly established over so long a period that nothing more should be necessary than to cite the following authorities:

Taylor v. *Mayo*, 110 U. S. 330, 334.
Everett v. *Drew*, 129 Mass. 150.
Schumann-Heink v. *Folsom*, 328 Ill. 321.
Dantzler v. *McInnis*, 151 Ala. 293, 44 So. 193.
Auxier v. *Aetna Insurance Co.*, 222 Ky. 243, 300 S. W. 617.
Bogert, Trusts and Trustees, p. 2123.
65 Corpus Juris, § 568, p. 703.

(b) Unlimited personal liability of the beneficial owners is characteristic of an "association".

On the other hand, the concept of a "trust association" was very largely developed in the litigation wherein it was established that the beneficiaries of a business trust operated under their control were individually liable as partners for the debts, contracts, and torts of the trustees. See:

Williams v. *Milton*, 215 Mass. 1.
Cook, Corporations, Eighth Edition, vol. III, pages 2247, 2248, 2251.
Weber Engine Company v. *Alter*, et al., 120 Kan. 557, 245 Pac. 143.

In *Burk-Waggoner Oil Association* v. *Hopkins*, 269 U. S. 110, in holding that a joint stock association, organized in the form of a trust, was an "association" under the income tax law, the Court pointed out (p. 111):

> "By the common law of Texas the partnership is not an entity, * * *; an association like the plaintiff is a partnership; its shareholders are individually liable for its debts as members of a partnership; * * *".

Also in *Durfee Mineral Co.*, 7 B. T. A. 231, there was held to be an association notwithstanding the fact that the beneficiaries were subject to unlimited liabilities as partners. On the other hand, in *Wolf*, 10 B. T. A. 835, there was held to be no association even though all the beneficiaries of the trust were expressly made "jointly and severally responsible" for all liabilities incurred by the trustees, and were expressly given "the rights and obligations of partners." To the same effect is *McGlone*, 22 B. T. A. 358.

(c) Unlimited personal liability of the trustees is characteristic of a trust, whether or not an "association".

It seems to be very commonly assumed that a trust resembles a corporation when the trust instrument provides that the trustees shall not incur any personal liability. This, however, disregards the well established rule of law that a trustee, even when he designates himself as such, incurs a personal liability which can be avoided only by specific stipulation in the contract and not by general provisions in the trust instrument.

Taylor v. *Mayo*, 110 U. S. 330, 334.
Allegheny Tank Car Co. v. *Culbertson*, U. S. Dist. Ct., Texas, 288 Fed. 406.
Austin v. *Parker*, 317 Ill. 348, 148 N. E. 19.
Schumann-Heink v. *Folsom*, 328 Ill. 321.
26 Ruling Case Law, § 175, pp. 1316-1317.
65 Corpus Juris, § 569, pp. 703-704.

In holding that an attempted limitation of liability in a trust instrument failed to save the trustees from personal liability, the Supreme Court of Kansas, in *Linn* v. *Houston*, et al., 123 Kan. 409, 255 Pac. 1105, said in part:

"* * * a common-law trust certainly has none of the attributes of limited liability or freedom from personal

liability which attach to limited partnerships and ordinary corporate organizations. Freedom from personal responsibility for breach of their business contracts is not a matter which a group of men can confer upon themselves by the creation of a trust, without the sanction of a statute to that effect, or without the intelligent contractual consent of the parties with whom they deal."

11. Continuity.

A continuing succession, irrespective of the identity of the component members, is frequently mentioned as distinctive of the corporate form or organization. However, except as it relates to separate legal personality, it is nothing more than or different from the continuity which is characteristic of any trust, regardless of changes in the identity of the trustees or of the beneficiaries.

12. Transferability of interest; issue of certificates.

The transferability of membership and beneficial interest is to some extent a corollary of a continuing succession. It is by no means essential to corporate form, since there is no transferable membership in the case of many corporations of such character as chartered colleges, hospitals, scientific and literary societies, and other public or private institutions which are unquestionably corporations. See *Sears, Roebuck & Co., etc.* v. *Commissioner*, C. C. A. 7, 45 Fed. (2d) 506, 508. On the other hand, the transferability of the interest of the beneficiary of a trust is an essential characteristic of the true trust. This is recognized by counsel for the Government in the brief filed in the *Morrissey* case (page 22). See also the following decisions:

Commissioner v. *Field*, C. C. A. 2, 42 Fed. (2d) 820, 822.

Edward T. Blair, 31 B. T. A. 1192.

65 Corpus Juris, § 303, pp. 546-550.

The issue of transferable certificates of beneficial interest clearly is not significant except as it reflects the size and formality of the organization and procedure. To furnish a written acknowledgment of the liability of the trustees and an evidence of the interests of the beneficiaries is a natural and common practice in all kinds of trusts, as well as in syndicates and many other forms of group activity. Of itself, therefore, this is not in any degree a corporate characteristic.

In *Trust No. 5833, Security-First National Bank, etc.* v. *Welch,* 50 Fed. (2d) 613, aff'd by C. C. A. 9, 54 Fed. (2d) 323, certiorari denied, 286 U. S. 544, holding that an "association" existed because of other corporate characteristics, the District Court said:

> "It is immaterial as to whether the shares or interests in the project are evidenced by certificates of stock or by any other written evidences of ownership. The beneficial interest of the beneficiaries in this trust clearly existed and was assignable and transferable as other personal property."

(2) The Lake View Land Association Had No Essential Resemblance to a Corporation and Was Not an "Association."

Whatever may be determined as to the formulation of a general rule or the establishment of specific tests for the distinction between an association and a true trust, it seems hardly possible that the classification of the Lake View Land Association as a corporation under the taxing statute can be sustained.

In all essential respects, this so-called association was merely an arrangement for the convenient holding of the title to a single parcel of real estate, such as is commonly employed for real estate held in connection with an individual or partnership business or by an individual investor in real estate. The income-producing activities of this enterprise (which must obviously be of primary significance in the determination of classification for income tax liability) were no different in any essential feature of method or form from those of a typical joint venture. The provisions of the trust instrument defining the powers, authorities, and obligations of the trustees lose most of their significance in view of the fact that the owners of the property were themselves trustees and that all their functions as trustees were performed exactly as if the title had been held merely in a simple tenancy in common. The terms of the trust instrument were significant only to give legal validity to the leases and other acts of the owners in the operation of the property.

Even the assignment of the beneficial ownership to the wives of the trustees and the changes which occurred in the identity of the trustees are not at all inconsistent with this point of view. The title being held by the trustees,

the changes which occurred took the form which was indicated and required by the existing situation. Had there been a mere joint ownership, there would have been a transfer of the interests in the land instead of an assignment of th interests in the trust, and there would have been an appointment of a managing agent instead of a designation of successor trustees. These differences are clearly differences merely in legal formalities and do not in any substantial way affect the ownership or operation of the property.

(a) The Lake View Land Association was not engaged in carrying on a business, but was a mere convenience for holding the title to real estate owned by two individuals as an investment.

Even if the Government is correct in its contention (which has been denied above, pages 12-18), "that the 'doing business' test which is emphasized by many decisions is the single criterion" of classification in a case of this kind (*Morrissey* brief, pp. 6, 13), or that "either the business test must be considered conclusive in itself or conclusive where there are some or all of the elements of centralized control, limited liability, and continuity of the business regardless of death or transfers of interest" (*Morrissey* brief, page 21), still the Lake View Land Association should not be taxed as an association because it was not engaged in carrying on a business, within the propet scope of that term as applied for this purpose.

The single property held by this trust was of the character which is commonly purchased and held for investment by individuals, who employ agents to attend to the details of management. The trustees were not dealing in real estate, never having acquired or negotiated for the

purchase of any other real estate (R. 28, 29). They merely held this particular property, which was specifically described in the trust agreement (R. 19). It does not appear that either the original owners or their wives were engaged in the business of operating apartment buildings, or that they held this property otherwise than as an income producing investment, and, as to one of them, as a place of residence (R. 28). Although Swanson was engaged in the business of a real estate broker and managing agent, this is quite different from the business of purchasing, operating, and selling real estate as a principal. For more than a year before the trust was created, the property was held in the name of Swanson, on behalf of himself and Otis. In this situation, surely no one would contend that a taxable "association" existed. The trust was organized at the suggestion of their attorney (R. 27), for reasons which related entirely to the handling of the title to the property. The change did not affect the operation of the enterprise and should have no effect upon the taxation of the income.

The description of the Iowa-Burk Syndicate, held not an "association" in *Commissioner* v. *Duckwitz*, C. C. A. 7, 68 Fed. (2d) 629, by the same court which held that the Lake View Land Association was an "association," could be applied almost verbatim to the Lake View Land Association, and the Court has furnished no explanation for the contradiction in the results. In the language of the opinion in the *Duckwitz* case, describing the former trust, we have interpolated the changes necessary to apply to the Lake View Land Association, as follows:

> "If we read the evidence and the trust agreement together it seems tolerably plain therefrom that a small group of people in Charles City, Iowa, [*two men in Chicago*] planned a simple and inexpensive method of handling a small venture in Texas oil speculation [*an apartment house investment in Chicago*].

"A single tract of ten acres [*lot and building*] was the field of their operation. Nowhere was there a suggestion that the trustees or members contemplated any oil mining [*real estate investment*] activities outside of this tract. Those who conceived the project planned that this local group, who were willing to back their hopes with a contribution sufficient to drill an oil well [*purchase the property*], should divide the profits [*income*]. The contributions of each were so small that a conveyance of a fractional interest in the real estate would have been cumbersome and impractical. [*Their attorney advised them against carrying the title in their individual names.*]"

The distinction between mere investment, or the holding of investment property, and the active employment of capital in a business has been recognized in the Regulations of the Treasury Department and has been pointed out in many decisions involving this question.

For example, in *Gardiner* v. *United States,* 49 Fed. (2d) 992, the Circuit Court of Appeals for the First Circuit said (pages 995, 996):

"These two trustees have no business office; they hold no formal meetings; they merely consult with each other; they have hired no officers, employed no agents to procure subscriptions to the capital of their trust; they have sold one parcel of real estate and bought another, otherwise their real estate holdings are as originally; they have so arranged their leases as not to require them to run heating plants, or even provide janitor or elevator service. In sum their actual performance is indistinguishable from that of ordinary testamentary trustees."

The same court, in the case of *Lansdowne Realty Trust* v. *Commissioner*, C. C. A. 1, 50 Fed. (2d) 56, has also said that the holding of property which had been leased for a term of five years was "not doing business in any sense" but was "nothing more than trustees ordinarily would be called upon to perform in the management of trust property."

In *Dunbar*, et al. v. *Commissioner*, C. C. A. 1, 65 Fed. (2d) 447, the concurring opinion of Morton, J. states:

> "The commercial management of property whether real or personal, for income or profit, seems to me engaging in business. These views were, however, on the most careful consideration, disapproved by this court in *Gardiner* v. *United States*, 49 F. (2d) 992, which covers the present case."

As to the character and extent of its business operations, the Lake View Land Association was obviously much less engaged in the conduct of a business than were the enterprises which have been held taxable as trusts in several other cases, including decisions of the Circuit Court of Appeals for the Seventh Circuit as well as those in other Circuits, including the case of *Coleman-Gilbert Associates* which is now pending before this Court.

Certainly, if it is held that no business was being carried on by the Coleman-Gilbert Associates, the same would be true of the Lake View Land Association, of which the operations were much less extensive and continuous. The Circuit Court of Appeals for the First Circuit, however, has given very little weight to the conduct of a business, as shown by its decision in *Commissioner* v. *Kelley*, 74 Fed. (2d) 71.

In *Commissioner* v. *Guitar Trust Estate*, 72 Fed. (2d) 544, the Circuit Court of Appeals for the Fifth Circuit

sustained the Board of Tax Appeals in holding that a trust was not an association although it managed large tracts of real estate and much personal property and carried on a ranching business, a cotton business, and a cotton seed business. Trusts and syndicates for the development and operation of oil properties have been held not to be associations by the Circuit Court of Appeals for the Ninth Circuit in *Commissioner* v. *Combs*, 76 Fed. (2d) 682, now pending before this Court and to be argued with this case, and by the Circuit Court of Appeals for the Tenth Circuit in *Commissioner* v. *Brouillard*, 70 Fed. (2d) 154, certiorari denied, under title of *Helvering* v. *Pryor & Lockhart Development Co.*, 293 U. S. 574.

In four cases, the Circuit Court of Appeals for the Seventh Circuit has held that a trust was not an association, notwithstanding business activities which in at least three cases were no less extensive or continuous than in the present case. *Commissioner* v. *Morriss Realty Company Trust*, 68 Fed. (2d) 648, concerned a family real estate trust which subdivided tracts of land, including some which it purchased, sold lots on installments, erected houses and sold them on time contracts, and borrowed money on mortgages for such operations. A large office building, operated by a managing agent, was owned by the trust involved in *Commissioner* v. *McCormick*, 68 Fed. (2d) 653. The oil venture involved in *Commissioner* v. *Duckwitz*, 68 Fed. (2d) 629, has already been mentioned.

The Zenith Real Estate Trust, held not an association in *Tyson* v. *Commissioner*, C. C. A. 7, 54 Fed. (2d) 29, was very similar to the Lake View Land Association, except that the Zenith Trust had only one long-term net lease with a single tenant, instead of a number of shorter leases as in the present case. A distinction on this ground, however, would fail to recognize that even under long-term leases

defaults and forfeitures occur, as demonstrated by the common experience in recent years, adjustments of rentals and modifications of other terms must be negotiated, buildings become obsolete and their replacement must be considered, opportunities to sell the properties arise, and other problems of supervision and management must frequently be met. In the case of the Zenith Real Estate Trust itself, it appears that the trustees found it necessary to engage a local agent to see that the taxes were paid, that the building was kept in repair, and that the other covenants of the lease were complied with. The trustees also sold the property prior to the expiration of the lease.

Such activities, and those which are required of any trust which holds income-producing real estate, differ only in minor degree from those which are here involved, where the trustees merely held title to the property while the two actual owners directed its management by their professional agents. From the point of view of the beneficiaries and trustees of the Lake View Land Association, just as the Court said of the Zenith Real Estate Trust, this was simply an investment in real estate which was expected to provide "with reasonable certainty for a sure and fixed income without either care or supervision."

(b) The Lake View Land Association had none of the characteristics of the corporate form of organization or mode of operation.

The simplicity of the organization and procedure of the present trust is so entirely unlike the characteristic forms and procedure of corporations that it is difficult to make a detailed comparison. The provisions of the trust agreement (R. 19-26) are much more like the familiar clauses of the documents governing ordinary real estate trusts than

like the terms of the charters or by-laws which control the operations of corporations, and which provide for meetings, majority rule, elections, powers of officers, managing boards, and other characteristic features of corporate organization.

Referring to the enumeration of corporate characteristics which has been given above (page 22), it will be seen that almost none of them was present in this case.

This was, of course, a voluntary association, but it had no semblance of formality or structure of organization and, as has been argued, it was not engaged in the conduct of a business.

As contrasted with the control over a corporation by the stockholders, the beneficiaries of the Lake View Land Association had no voice in the selection of the trustees, who were entirely self-perpetuating (paragraph 10 of the Trust Agreement, R. 24), and the trustees were given absolute and unrestricted control over the affairs of the trust (paragraphs 3 and 4 of the Trust Agreement, R. 19-21). More significant, perhaps, is the fact that the owners of the property made themselves trustees and one of them managed the enterprise for the benefit of his associate and their wives, just as would have been done if the parties had held the legal title in common instead of owning merely the beneficial interest.

The instrument governing the Lake View Land Association contains no provision under which any majority of the beneficiaries were authorized to take any action which would in any respect bind all of the beneficiaries as a class (except that upon the single matter of amendment of the trust agreement, it was provided (in paragraph 13 of the Trust Agreement, R. 26) that the agreement of beneficiaries holding three-quarters or more of the receipts

issued should be binding upon all of the beneficiaries and also upon the trustees). In this respect, this trust is therefore strikingly familiar to the ordinary and typical trust, and dissimilar from corporations, joint stock companies, and analogous associations.

This enterprise does not present the principal economic characteristic of a corporation, in that it did not involve the aggregation of a large amount of capital contributed by a large number of investors. On the contrary, it was essentially a personal investment, in which only two friends and associates joined. There were no preferences or priorities among the owners.

Instead of the characteristic authority to accumulate a surplus and to make discretionary distribution of income, the trustees of the Lake View Land Association were required to divide the net income semi-annually or oftener (paragraph 6 of the Trust Agreement, R. 22).

The trust had no aspects of legal entity or personality, and was not the subject of any special recognition or control by state statute.

The activities of the trustees of the Lake View Land Association certainly resembled as little as possible the typical activities of a board of corporate directors. The absence of any formal meetings or records of meetings and of any reports to the beneficiaries (except those given by informal conversation) is much more like the traditional trust or joint venture than the traditional corporation.

In common with all true trusts, the beneficiaries of the Lake View Land Association were not personally liable for obligations incurred by the trustees, but the trustees were subject to unlimited personal liability, under the authorities previously cited. The trust also had continuity of

succession and the interests of the beneficiaries were transferable, as would be true of any trust.

In no essential respect, did this trust employ any of the characteristic forms of organization or modes of procedure which would be required to justify classifying it as an "association."

Conclusion.

It was obviously the purpose and intention of Congress that the tax burdens imposed upon business corporations should likewise be shared by those unincorporated enterprises which were essentially similar to a corporation in form of organization and mode of operation. The attitude of the Supreme Court in *Hecht* v. *Malley* and in *Burk-Waggoner Oil Association* v. *Hopkins*, is completely in accord with this legislative purpose, but it has been ignored and defeated by the Circuit Court of Appeals for the Seventh Circuit in the present case. A trust which has no substantial resemblance to a corporation in form of organization or in method of operation has been subjected to the corporate tax. That decision should therefore be reversed by this court.

Respectfully submitted,

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